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**MEMORANDUM TO THE DEPUTY MINISTER**

**ANALYSIS OF THE CANADIAN CHAMBER OF COMMERCE REPORT  
"IS CANADA SUFFERING FROM DUTCH DISEASE?"**

**(Information by July 20, 2012)**

**SUMMARY**

- This note provides a summary of the June 28, 2012 Canadian Chamber of Commerce report, "*Is Canada Suffering from Dutch Disease?*" (Attachment 1). Like other recently published analyses, it concludes that there is no clear and strong causality between the resource commodity prices, the Canadian dollar and the decline in Canada's manufacturing sector.
- The report outlines two main reasons for this conclusion:
  - the appreciation of the Canadian dollar reflects the interaction of various factors, including Canada's relative better fiscal position *vis-à-vis* the U.S and Europe, differences in interest rates, and short term capital flows; and
  - the decline in the manufacturing sector's share of output over the past decade is part of an ongoing 30-year process that is not unique to Canada.
- The report also emphasizes that Canada's oil sands generate economic benefits across the country. Citing a May 2012 Toronto Dominion Economics report, it indicates that oil exports and investment in machinery, equipment and infrastructure in the oil sands accounted for one third of Canadian economic growth between 2010 and 2011.
- The conclusions of the Chamber of Commerce report are in line with other analyses (e.g., Jack Mintz's in the *Financial Post* in March 2012) and our analysis provided to the Minister on June 7, 2012.

good information  
to highlight  
in speaker

## **BACKGROUND**

On June 28, 2012, the Canadian Chamber of Commerce released a report, "*Is Canada Suffering from Dutch Disease?*" asserting that there is no clear and strong causality between the resource boom, the Canadian dollar and the decline of the Canadian manufacturing sector.

The report notes two main reasons for this conclusion as described below:

### **1. The Appreciation of the Canadian Dollar**

While the report indicates that commodity price movements lead to exchange rate movements, it suggests that an appreciation of the Canadian dollar is a result of the interaction of various factors.

For example, the report cites a 2010 Bank of Canada report which concludes that a combination of commodity prices and Canada's relatively better fiscal position explain more than 60% of the appreciation in the Canadian dollar relative to the U.S. dollar in the medium term and 46% over the long term. The Chamber of Commerce report also notes that higher interest rates in Canada made Canadian dollar assets more attractive to foreign investors, boosting demand for the Canadian dollar and driving its value higher in recent years. Additionally, increased capital flows into Canada as a result of both a positive investment climate and efforts to mitigate risk during times of economic uncertainty were also a factor contributing to the appreciation of the Canadian dollar.

Interestingly, the report notes that in 2008, the value of the Canadian dollar fell below parity with the U.S. dollar while oil prices rose to record highs of close to \$US145 in July 2008.

### **2. The Decline in the Manufacturing Sector**

The Chamber of Commerce report also notes that there have been challenges for Canadian manufacturers, but explains that this is part of an ongoing 30 year process consistent with trends observed in other industrialized nations. The report provides some potential reasons for the decline in Canadian manufacturing output and employment including:

- lower productivity growth in Canada relative to the U.S, resulting in a decline in the competitiveness of Canada's manufacturing sector relative to the U.S.;
- on the demand side, relatively slow global growth in demand for manufactured products overall as the global economy shifts to a greater reliance on services; and
- on the supply side, increasing competition from emerging countries, notably China, in manufacturing. China is now the world's largest manufacturing power and accounts for a fifth of global manufacturing.

The Chamber of Commerce's report adds that the Canadian manufacturing sector is adjusting to the reality of a high Canadian dollar and that overall the Canadian economy has benefited from the natural resources boom, and in particular oil sands development. For instance:

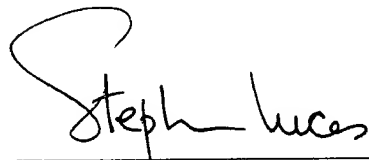
- a Toronto Dominion Economics report in 2012 estimates that increased oil exports and investment in machinery equipment and infrastructure in the oil sands accounted for one third of Canada's economic growth between 2010 and 2011; and
- in an April 2012 speech, the Governor of the Bank of Canada, Mark Carney, noted that 1 in 12 oil sands suppliers are from the Kitchener-Waterloo region and, Ontario's exports to Alberta of mining-related services rose substantially in recent years.

## CONCLUSION

The outcomes of the Chamber of Commerce's report is consistent with our June 7, 2012 (*Analysis of Recent Studies of Dutch Disease in Canada*, N12-131044) and March 27, 2012 (*Jack Mintz's Article in the Financial Post on Dutch Disease in Canada*, N12-130733) analysis on the Dutch disease.

We will continue to monitor economic research on this issue, as well as the benefits of Canada's natural resource sector to the rest of Canada's economy. Related ongoing work includes:

- analysis of potential economic impacts of natural resource development in the *Defining the Opportunity* project;
- preliminary discussions with Industry Canada on understanding the value chain associated with major natural resource projects in Canada for future discussion at the Economic Trends and Policies DM Committee; and
- engaging the Privy Council Office, Intergovernmental Affairs, on regional disparities and the role of natural resources.



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Attachment: (1)

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Science Policy Evidence and Analysis/ Science Policy Integration

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